ARW

REBUTTAL TESTIMONY OF

JOSEPH M. LYNCH

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2001-420-E

Q. Did you previously present direct testimony in this matter?

A. Yes, I did.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to refute certain aspects of the direct testimony presented by Mr. Lanzalotta on behalf of the Consumer Advocate.

Q. Mr. Lanzalotta suggests that SCE&G did not consider a purchased power option (page 5, lines 7-8). Is this correct?

A. No. SCE&G considered the purchased power option, but based on our experience with this option as part of the siting process for the Urquhart Re-Powering Project, we eliminated the purchased power option for the reasons stated in the Company's response to Consumer Advocate Interrogatory 1-1. Mr. Lanzalotta quotes a portion of this interrogatory response at page 4, line 24 - page 5, line 5 of his testimony. The entire response reads as follows:

> SCE&G did consider purchased power as an option but decided not to issue a Request for Proposals (RFP) as it had done prior to the decision to retrofit the Urquhart Plant, for which the Commission provided a siting certificate in 2000. The Company eliminated purchased power because self-owning capacity is 1) more flexible, since the capacity does not have to be scheduled through a second party, usually a day ahead or intra-day with penalties; 2) more reliable, since the Company would maintain the plant and the availability of the capacity would not be at risk because of the economics of the purchased power agreement; 3) more

economical in the long run, since purchased power costs tend to rise in the market place with inflation while the cost of carrying a self-owned plant will decrease over time because of depreciation; and finally 4) building generation in South Carolina provides economic benefits to the local community and the state.

Q. What is SCE&G's response to the points Mr. Lanzalotta makes with respect to scheduling flexibility (page 5, lines 9-21)?

A. For a discussion of this issue see the rebuttal testimony of Mr. Cunningham.

Q. Mr. Lanzalotta disputes that self-owned generation will be more reliable than a purchased power contract (page 5, line 23 – page 6, line 10). Do you agree?

A. No. If SCE&G owns the plant, it will assure that the plant is well maintained. Additionally, SCE&G will continually monitor, perform maintenance, and make improvements as needed. SCE&G also will schedule maintenance and outages for the plant in conjunction with the schedules of its entire generation system to assure a reliable supply of power for its customers.

Q. Mr. Lanzalotta suggests that the economics of a purchased power agreement is not a source of risk (page 5, line 29 – page 6, line 3). Do you agree?

A. No. The primary goal for a party selling generation capacity in the market is to make a profit. I have no doubts that if the economics of a project turn sour, the selling party (the generator) will consider walking away from the project. The generator may not walk away and abandon or breach the contract, but breach will always be an option. On the other hand, SCE&G's primary goal is to serve its native load. Walking away is not an option.

Q. Can you give an example of a company defaulting on a power purchase contract?

A. Federal Energy Sales Company failed to deliver power per its contract of June 23, 1998. This had a cascading effect causing the City of Springfield and Power Company of America to default on their contracts. ["Staff Report to the Federal Energy Regulatory Commission on the Causes of Wholesale Electric Pricing Abnormalities in the Midwest During June 1998," page 4-2]. Another example is a case involving Cinergy. On July 30, 1999, Cinergy invoked a force majeure clause to justify not supplying power to traders and other counter-parties. Other party players contended "there was power available but Cinergy was not willing to pay the very high prices required to get it" in order to fulfill its contracts. ["Electric Utility Week", August 16, 1999, page 1].

Q. Mr. Lanzalotta contends that SCE&G "could insist on contractual protections against a failure to deliver" (page 6, lines 8-10). Do you agree?

A. Yes, I do, but receiving payment of financial damages due to a contractual breach is not the same thing as having power when it is needed. Moreover, such "collection" efforts can involve protracted litigation. I would also add that, although SCE&G would always look into the creditworthiness of any counter-party, dependence on a second party in a contractual relationship increases risks. Consider that the energy giant Enron Corporation is now saying that its financial records from 1997 through the first half of 2001 "should not be relied upon."

Q. Are there regulatory considerations related to Mr. Lanzalotta's comments on the reliability of purchased power?

A. Yes, regulatory oversight is directly affected by the extent to which a utility relies on purchased power. In the case of utility generation, the South Carolina Public Service Commission has regulatory control over jurisdictional electric utilities as to the 1) cost of the plant; 2) operational quality of the facility, including proper maintenance; 3) fuel procurement costs; and 4) the financial integrity of the generating company.

In contrast, if a regulated utility purchases power from a market generator, the Public Service Commission has review of the purchased power contract only. It has no jurisdiction as to how the generating facility is operated and maintained; fuel procurement; and, perhaps most importantly, no ongoing review of the financial integrity of the generating company.

Q. Mr. Lanzalotta contends that "capacity purchases can be sized to exactly match capacity needs" and that the "lumpiness" of adding wholly-owned capacity "tends to increase the costs of wholly-owned generation relative to purchased power options" [page 6, lines 12-23]. Do you agree?

A. No, I don't. SCE&G could add capacity that very nearly matches load growth, but, in this case, it is more cost effective to add a larger, more efficient plant. In the present situation SCE&G is actually building a plant that is larger than needed because it is more economical to do so than to build a smaller plant that matches the load more closely. Here, the economies of scale associated with the additional capacity outweigh the costs. In considering costs, it is important to keep in mind that, when a plant is added to the system, regulatory accounting requires it to be depreciated over time causing its cost to decrease. On the other hand, when construction of new capacity is delayed, the cost is expected to increase with inflation. By the same analysis, the purchased power option is expected to cause additional costs when the contract expires because it will then be necessary to re-enter the power market and purchase capacity at a higher price.

Theoretical ability to manage "lumpiness" through contracts does not offset the concerns SCE&G articulated.

Q. Mr. Lanzalotta suggests that "purchased power might be less expensive" than self-owned capacity [page 7, lines 4-6]. Do you disagree?

A. I do not disagree that purchased power "might" be less expensive, at least in the short run. It is important to keep in mind, however, that the lowest cost option is not necessarily the best option, which would include a balancing of short-run costs, long-run costs, reliability, flexibility in operations, and the economic benefits of self-owned generation. Additionally, I would point out that SCE&G issued a "Request For Proposals"(RFP) for purchased capacity to be delivered in 2002 as part of the Urquhart Re-Powering Project and, after more than a year of meeting with respondents and evaluating the proposals, concluded that purchased power was more expensive than self-owning. I believe that one reason for this is that the cost of building new generation is about the same regardless of who builds the power plant.

Q. Mr. Lanzalotta contends that "there is not sufficient data from which to determine whether the proposed facilities will serve the interests of system economy" [page 7, lines 25-26]. Do you agree?

A. No. I believe the evidence presented in this case will allow the Commission to conclude that a self-build option is preferred over a power purchase agreement and that the Jasper Plant is the lowest cost self-own option.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.